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ABSTRACT

This economics unit of study consists of 10 lessons. Each lesson sets out key terms (such as demand, scarcity, monetary costs, property rights, and cost/benefit analysis); outlines the national content standards addressed; lists objectives; provides teaching and discussion ideas; suggests sample interactive discussion problems and sample small group discussion problems; and finally, provides definitions for the key terms. (BT)

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EFL Lesson One

EFL Hypothesis for the Week:
Social cooperation develops spontaneously in societies that protect private property rights and allow people to exchange freely.

SCARCITY AND CHOICE

Key Terms:

Demand	Supply
Scarcity	trade-offs
Opportunity Cost	Marginal Costs/Benefits

National Content Standards Addressed:

Standard 1 - Productive resources are limited. Therefore, people cannot have all the goods and services they want; as a result, they must choose some things and give up others.

Standard 2 - Effective decision making requires comparing the additional costs of alternatives with the additional benefits. Most choices involve doing a little more or a little less of something: few choices are "all or nothing" decisions.

Standard 3 - Different methods can be used to allocate goods and services. People acting individually or collectively through government must choose which methods to use to allocate different kinds of goods and services.

Lesson Objectives (7)

1. Define scarcity and give examples.

2. Establish causation: Scarcity necessitates choice; therefore trade-offs cannot be avoided.
   - Discuss rationing - relate to scarcity and choice.
   - Ration CDs, (see Teaching and Discussion Idea #1 below) or list and describe several methods of rationing.

3. Define opportunity cost.
    - Differentiate between trade-off and opportunity cost: the cost is the "next-best" alternative.
    - Offer other ways to conceptualize cost: "Choosing is Refusing" or "Cost is the foregone alternative."

4. Develop examples to illustrate the characteristics of cost.
    - All costs are costs to the decision-maker and are thus subjective in nature: costs are "to" someone.
    - Only actions have costs; "things" have no cost independent of decisions about using them.
    - All costs lie in the future; the anticipation of future consequences shapes peoples' decisions.
    - Emphasize that "consequence" and "opportunity cost" are different.

5. To the decision-maker, the relevant value of something is its marginal value.
    - Define marginal as additional, or "a little more or a little less," or "the next unit."
    - A person's willingness to bear costs is situation-specific: the marginal value of a cup of water is very low to those who can quickly obtain it with the turn of a faucet; it's value is high to someone dying of thirst in a desert.

6. Prices reflect opportunity costs and help buyers make decisions.
    - Cost and price are not the same, in economics terms.
    - A rising price (or a high price) means that buyers must bear higher opportunity costs: they must give up more to obtain something. All other things being equal, they will choose to buy less.
    - A falling price (or a low price) means that buyers bear lower opportunity costs: they must give up less of other things to obtain something. They will choose to buy more.
    - Law of Demand.

7. Prices reflect opportunity costs for suppliers, too.
    - Suppliers make choices; they could supply other things.
    - Develop examples.
    - As the opportunity cost of supplying things to others decreases, people are willing to supply more.
    - As the opportunity cost of supplying things to others increases, people are willing to supply less.
    - Law of Supply.

Teaching and Discussion Ideas:

Bring 3 CDs, of various types of music, to the lecture. Ask if anyone wants them.

Presumably, more than one person will want each one and then you can ask the class how to solve the dilemma. What process and/or criteria should be used to distribute or ration the CDs?

Examine the nature of the different possibilities:
first-come-first-served, lottery, contest or winner-take-all, money-price, need, auction, sharing equally, etc. (corresponds with lecture objective #2)

Sample Interactive Discussion Problems:

1. Give a student the choice of a package of gum or a candy bar. What did he choose? What did he refuse; what is his opportunity cost?

    - Poll other students to see if they would make the same choice. How and why would students' opportunity costs vary?
    - Emphasize that the opportunity cost (what is refused or given up) may change as the available alternatives change and as people's tastes change.
    - Next, take from a bag an old (and sweaty?) T-shirt that you brought with you and offer to sell it.
    - Why will nobody buy it?
    - Is it's value different if it belonged to Brad Pitt or Brett Favre instead of belonging to you? Why?
    - Give a student the choice of the old T-shirt or a new one. Which did she/he choose? Which did she refuse? What was her opportunity cost to obtain the new shirt? Was that a high or low cost?

    Emphasize that "Choosing Is Refusing." What you give up - or refuse - is your opportunity cost (and your perceptions determine its value).

2. Bring three similar, but not identical, items to give away. (Candy bars, donuts, cans of pop all work well.)
    - Ask a student to choose which of the three items he wants.
    - Discussion: Was his choice "free," or was there an opportunity cost?

Sample Small Group Discussion Problems

Pose problems incorporating the idea that benefits and costs are relative to specific situations and to individual perceptions:

Use opportunity cost to explain:

1. why farmers often wait until a rainy day to do errands in town, while a man in a new suit will decide to forego his errands on the same day;

2. why a highly talented person who travels a lot might hire a chauffeur;

3. why businessmen often buy full-fare airline tickets while people planning vacations fly when rates are lowest;

4. why Americans today find themselves much more pressed for time than their great -grandparents were, despite the fact that we have so . many machines and appliances that save us labor and time;

5. why young women in India cut the grass surrounding the Taj Mahal with kitchen shears rather than using lawn mowers;

6. why movie stars, fashion models, and rock singers have higher divorce rates than the rest of the American population.

Pose a problem for a small-group discussion, that encourages students to consider that changing prices reflect changing opportunity costs.

1. Much housing in Miami was destroyed by Hurricane Andrew; what happened to the cost to tenants of renting an apartment? What happened to the cost to landlords of renting space to any particular tenant?

2. A store owner buys a truckload of last year's very popular style of jeans and puts them on display in his store. Plaid flannel pants are the rage this year and most people walk right by the jeans display to stand in line to buy plaid flannels.
   - What is the cost to the store owner of selling a pair of plaid pants to any particular buyer?
   - What is the cost to the store owner of selling a pair of jeans to any particular buyer?
   - Over the year, what happened to the cost to buyers of purchasing a pair of jeans?
   - What happened to the cost to the seller of NOT selling a pair of jeans to any particular seller?
   - What caused costs to change?

Definitions

Demand - The relationship between prices and the corresponding quantities of a good or service buyers are willing to purchase at any given point in time.

Marginal benefit - The increase in total benefit that results from producing, purchasing, or consuming an additional unit.

Marginal cost - The increase in total cost that results from producing an additional unit.

Opportunity cost - The most highly valued sacrificed alternative; the value of the "next-best" choice.

Scarcity - Scarcity means that people cannot obtain as much of something as they want, without making a sacrifice or bearing a cost. Scarcity defines a relationship - between the amount of something we want and the amount that is available.

Supply - The relationship of prices to the quantities of a good or service sellers are willing to offer for sale, at any given point in time.

Trade-off - A choice between alternatives that reveals the opportunity cost of selecting one alternative over the other.

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EFL Lesson Two

Markets

Key Terms:

Exchange
Transaction costs
Property rights
Interdependence
Non-monetary costs
Money prices
Specialization
Market-clearing price
Monetary costs

National Content Standards Addressed:

Standard 4 - People respond predictably to positive and negative incentives.

Standard 5 - Voluntary exchange occurs only when all participating parties expect to gain. This is true for trade among individuals or organizations within a nation and usually among individuals or organizations in different nations.

Standard 7 - Markets exist when buyers and sellers interact. This interaction determines market prices and thereby allocates scarce goods and services.

Standard 8 - Prices send signals and provide incentives to buyers and sellers. When supply or demand changes, market prices adjust, affecting incentives.

Standard 9 - Competition among sellers lowers costs and prices and encourages producers to produce more of what consumers are willing and able to buy. Competition among buyers increases prices and allocates goods and services to those people who are willing and able to pay the most for them.

Lesson Objectives (9)

1. Review the nature of voluntary exchange, drawing on the experiences in "Why People Trade."
   - No one forced people to trade; why did they? (anticipation of benefit)
   - Who benefited from each exchange? (mutual benefit)
   - Why were some people able to trade more than others?
   - What was the opportunity cost of the trade you made?
   - Were there costs other than the item you gave up in the trade? (search and transaction costs, lost opportunity to trade with

someone else etc.)

2. Define market - and discuss why they are our preferred method of rationing. (Relate to "Why People Trade" – was that a market? how so?)
   - How do people behave in markets?
   - Markets work as positive sum games when:
     - there are clearly defined "rules of the game;"
     - property rights are clearly established and are protected; and
     - there is freedom to exchange.
   - How would our market have been different if we had usedmoney?

3. Define incentives as both rewards and penalties for behavior. There are monetary and non-monetary incentives.

4. The role of prices in markets.
   - Prices provide information.
   - Prices act as a rationing mechanism.
   - Prices are incentives - for buyers and sellers.

5. Prices play a crucial coordinating role in commercial societies; they provide incentives for buyers and sellers to act in ways that lessen the impact of scarcity.
   - Reminder of law of demand from first lecture: . How do buyers react to changing prices?
   - Reminder of law of supply from first lecture: How do sellers react to changing prices?

6. Define and develop examples of market clearing price.
   - Market clearing prices are evidence of the cooperative nature of commercial societies; they help to balance the amount people want to buy with the amount others want to sell.

7. Clearly defined property rights and prices that move freely in response to changing conditions of demand and supply encourage exchange and the creation of wealth.
   - When prices are prevented (whether by custom, ignorance, or government action, for example) from changing in response to changes in demand or supply:
     - the opportunity cost of exchange rises;
     - fewer exchanges take place; and
     - cooperation becomes less likely and less effective.
   - While price controls may prevent rising prices, they cannot prevent rising costs; non-monetary costs (search and transaction costs) will rise instead.
   - Non-monetary costs are usually deadweight costs: costs to demanders, such as waiting in line, that do not benefit suppliers.

- Reducing the costs of arranging voluntary exchange (transaction costs) increases wealth; increasing transaction costs inhibits the creation of wealth.

8. Markets and prices encourage specialization and interdependence.
   - Refer to "Why People Trade" activity: Why do people trade for things they want rather than producing everything themselves?
   - In a society characterized by extensive specialization, people obtain most of what they want by supplying things that satisfy the wants of other people.

9. Markets are the result of interaction between supply and demand.
   - Monetary prices are incentives for buyers and sellers to act cooperatively.
   - This cooperation is impersonal and is based on people making choices that reflect their perceptions of opportunity costs.
   - This cooperation results in clearing markets of both supply and demand.

Teaching and Discussion Ideas

Sample Small Group Discussion Problems

Pose a problem for small groups, teacher-led discussions that requires students to consider the advantages and disadvantages of different systems of rationing:

1. War has broken out in the Middle East, sharply reducing the supply of oil to the United States. The government has decided to order a 20% reduction in the production of gasoline for motor vehicle consumption in order to save petroleum. Average annual U.S. consumption of gasoline for motor vehicles before the outbreak of war was 120 billion gallons. It must now be reduced to 96 billion gallons. You are responsible for designing a system to allocate the reduced supply of gasoline. How will you do it?

Pose problems requiring students to recognize that time and transaction costs are taken into account in purchasing decisions.

2. What is the difference in the cost of buying a coke with no ice from the machine in the mall entryway and buying one with ice from the vendor at the other end of the mall (¼ mile away) if the price of both cokes is 75¢?

Pose a problem that allows students to discover the ability of money and pricing signals to accommodate to particular situations of supply and demand.

3. Suppose that a series of hurricanes devastates the Bahamas. Most

buildings are destroyed; there are many deaths; and all production is disrupted. Predict what would happen if, instead of sending old clothes and foreign aid packages, the United States set up many distribution points and handed out $50/day to any Bahamian, of any age, who showed proof of residency?

Pose a problem that allows students to predict the impact of price controls.

4. Suppose that a summer of flooding in the Midwest is followed by a summer of severe drought. Two successive failures of the wheat crop mean that bread production is severely reduced.
   - Predict what would happen if the government, with the well-being of the poor in mind, prevents the price of bread from rising.
   - Predict what would happen, in both the short-run and the long-run, if the government allows the price of bread to rise.

Definitions

Exchange - Trade; voluntary agreements between buyers and sellers.

Market clearing price - The price at which all that suppliers are willing to sell equals all that buyers are willing to purchase; the price at which quantity demanded equals quantity supplied.

Non-monetary costs - See transaction costs.

Property rights - The conditions of ownership, including the rights and restrictions regarding use, ownership, and sale.

Specialization - Occurs when individuals, businesses, regions or nations concentrate on producing only those goods and services that they can best (most efficiently) produce, given their existing resources.

Transaction costs - The resources (like time and energy) that are used in making an exchange. Examples of transaction costs are time spent shopping or the time and energy necessary to negotiate a contract.

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EFL Lesson Three

Markets

Key Terms: Competitive Markets Market Power
Price Discrimination

National Content Standards Addressed:

Standard 7 - Markets exist when buyers and sellers interact. This interaction determines market prices and thereby allocates scarce goods and services.

Standard 8 - Prices send signals and provide incentives to buyers and sellers. When supply or demand changes, market prices adjust, affecting incentives.

Lesson Objectives (5)

1. Competition regulates markets:
   - by making sellers responsive to the wishes of buyers;
   - by rewarding the most efficient, or least-cost, sellers with returns equal to or above their opportunity costs; and
   - by encouraging the flow of resources to their most highly-valued uses.

2. In competitive markets, price increases caused by changes in either supply or demand are the result of increases in marginal costs; prices and marginal costs are directly related.
   - The higher prices which accompany increased demand indicate buyers' willingness to bear higher opportunity costs in order to purchase particular goods and services.
   - The higher prices which accompany decreased supply indicate the higher opportunity costs producers must bear (because of higher prices for resources or the existence of other, more profitable, production alternatives) in order to provide particular goods and services.

3. The term "market power" refers to the influence that any particular buyer or seller can exercise over the price of a product. Market structures range from highly competitive, in which there are so many buyers or sellers that none can influence the market price, to the other extreme in which a single

buyer or seller faces no competition and therefore wields great market power.

- In markets characterized by free entry, attempts by sellers of products or resources to raise prices in the absence of cost increases are generally unsuccessful.
- Similarly, in markets characterized by free entry, attempts by buyers of products or resources to lower prices in the absence of cost decreases are generally unsuccessful.

4. The persistence of large differences between price and production cost usually indicates that entry is restricted.
   - This may be the result of limited availability of specialized resources or of government restriction to entry.
   - Government intervention in response to a special interest group often results in reduced competition and the creation of market power for that group.
   - Because the costs imposed on consumers by the government response to any particular lobbying effort are diffuse and individually small, consumers generally do not organize to oppose the influence of the special interest groups. The benefits to the special interest groups are large enough to give them an incentive to organize and lobby.

5. Price discrimination, charging different people different prices for the same good, is possible because individuals place different subjective values on goods.
   - Price discrimination is most likely to occur when the seller can identify groups of buyers who place different relative values on a good or service and when resale of the item among customers is either impossible or highly unlikely.
   - Pricing of airline and movie theater tickets are good examples of price discrimination.

Teaching and Discussion Ideas

Run an additional round of the market teaching activity which the mentor teacher demonstrated just prior to this lecture.However, this time, use a disproportionate number of buyers and sellers.

- Run the activity with students only, identifying two students as sellers and the rest of the students as buyers.
- Position the two sellers a few chairs apart and give them each half of the seller cards from the previous activity.
- Instruct the sellers that they can make as many transactions as they wish in each round, but they must draw a new card from their stack of seller cards for each transaction.

- Distribute the buyer cards, one each, to the rest of the students.
- Instruct the buyers that they may make transactions as in the last round of the previous activity.
- Record all transactions. (The number of transactions will be slightly less and the average price will be slightly higher than in the previously played rounds.)
- Debrief:
    - Was there competition between the sellers?
    - Who seemed to have more market power - the buyers or the sellers?
    - Which type of market did you prefer, as a buyer?as a seller? (corresponds to lecture objectives #3 and #4)

Sample Interactive Discussion Problems:

Pose a problem requiring students to isolate and identify the characteristics of a market which makes price discrimination possible.

1. Why do movie theaters charge different people different prices for tickets, but charge everyone the same price for popcorn?

Sample Small Group Discussion Problems:

Pose a problem requiring students to design a system of price discrimination.

2. Design a system of price discrimination for highway use in a large city based on what you know about traffic usage during a typical week.

Pose a problem in which students consider the incentive structure inherent in a cartel.

3. Suppose that five major oil-producing nations of the world get together and, with the goal of increasing revenue and profit, agree to cooperate in such a way as to act as if they were a single supplier.
    - What actions could they take to achieve their goal?
    - Consider each action on the list individually. What is the likely impact on the price of oil? Why?
    - What is the likely result in terms of the revenues of oil producers?
    - Consider each action on the list individually. Are the benefits and costs of each action the same for all producers?
    - What is the incentive for individual producers to abide by any agreement?
    - What is the incentive for individual producers to cheat on any. agreement?
    - What would be necessary in order to maintain (enforce) the agreements?
    - What do you predict will happen in the long run?

Definitions

Competitive markets - Markets characterized by relative ease of entry and exit and by large numbers of sellers who provide products which consumers regard as substitutes for one another.

Market power - The degree to which a business firm is able to earn larger than normal profits, market power is inversely related to both the degree of competition in the market and the ease of entry and exit.

Price discrimination - The practice of charging different groups of consumers different prices for the same good or service.

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EFL Lesson Four

Markets in Action

Key Terms:

Demand	Exchange
Transaction Costs	Supply
Marginal Analysis	Market Clearing Price

National Content Standards Addressed:

Standard 1 - Productive resources are limited. Therefore, people cannot have all the goods and services they want; as a result, they must choose some things and give up others.

Standard 2 - Effective decision making requires comparing the additional costs of alternatives with the additional benefits. Most choices involve doing a little more or a little less of something: few choices are "all or nothing" decisions.

Standard 3 - Different methods can be used to allocate goods and services. People acting individually or collectively through government must choose which methods to use to allocate different kinds of goods and services.

Standard 4 - People respond predictably to positive and negative incentives.

Standard 5 - Voluntary exchange occurs only when all participating parties expect to gain. This is true for trade among individuals or organizations within a nation and usually among individuals or organizations in different nations.

Standard 7 - Markets exist when buyers and sellers interact. This interaction determines market prices and thereby allocates scarce goods and services.

Standard 8 - Prices send signals and provide incentives to buyers and sellers. When supply or demand changes, market prices adjust, affecting incentives.

Standard 9 - Competition among sellers lowers costs and prices and encourages producers to produce more of what consumers are willing and able to buy. Competition among buyers increases prices and allocates goods and services to those people who are willing and able to pay the most for them.

Lesson Objectives (5)

1. The purpose of lecture session 4 is to encourage students to practice applying the concepts they have been introduced to in the first three lectures, and to help them transfer their knowledge from simple examples, to more complex problems that have been reported in the news. Hopefully, students will begin to experience the usefulness of economic reasoning in providing insight into problems that often seem hopelessly complicated.

2. Sample problems are presented below, but you are encouraged to substitute. other problems that you are comfortable with and that may be drawn form more current news articles. In general, problems should become more complex as the problem-solving group becomes bigger.

3. Assign students and teachers to solve a problem from set one individually. Go over the problem with the large group, stress how the problem is the same as and how it is different from examples used in the lectures.

4. For a problem in set two, ask students to work in pairs and then to share their answers with another pair, before you discuss the problem with the large group.

5. Ask students and teachers to work on the problem(s) in set three individually, for five minutes. Then move students into their morning discussion groups with teachers to discuss their answers. Spend a few minutes before the break reviewing the answers with the entire group.

Set One

A major step toward mastering the economic way of thinking is learning to reason in terms of supply and demand. On the questions below, your answers are less important than the reasoning with which you arrive at those answers. Begin by considering the current situation as described in the problem. Does the event described affect supply? demand? both? neither? Does it cause supply or demand to increase? decrease? What effect will the change have on the price and the quantity exchanged in the market? Don't be content merely to conclude that the price will rise or the price will fall. Would you expect a large or a small change in price or in the quantity exchanged? Keep in mind that the answer will often depend on the length of time you are allowing for adjustments to occur. Are you predicting a very short-run effect or are you thinking about the long-run effect? (Some students may find it useful to sketch a small supply and demand graph to guide their thinking.)

A. Using supply and demand analysis explain why the price of roses always seems to rise just before Valentines day.

1. How would a freeze that killed one-half of the rose crop effect the price? Why?

2. What would happen in the market for fine chocolates if one-half of the rose crop freezes? Why?

Or

B. A story on the front page of The Wall Street Journal on October 22, 1996, told about troubles in the Bob Evans Restaurants. The Bob Evans chain, which started as a truckers diner in the late 1940s, currently includes 380 restaurants with annual sales of more than $800 million. However, at the annual shareholders meeting on the family farm, disappointment and anger were the order of the day and the meeting focused on reported declines in the quality of food and service, and on the declining price of the company's stock. In searching for an explanation for the plight of the Bob Evans chain, the Journal noted that, rising hog prices combined with Americans' healthier eating habits have stalled sausage sales, which account for almost 25% of the company's revenue.

1. Use your understanding of supply and demand to analyze the impact of the conditions described in the quotation at the end of the article summary. Which issues effect demand? Which issues effect supply?

2. Hypothesize about the equilibrium price, quantity supplied and quantity demanded this year at Bob Evans as opposed to last year.

Set Two

C. Two years ago the city of Denver had an initiative on the general election ballot, asking voters to raise Denver's minimum wage to 40% above the national minimum wage.

1. How would things in Denver have changed if it had passed?(what would be the same? What would be different?)
2. Predict the effect of this legislation on market(s) for labor in Denver; in the suburbs outside of the city.
3. Where would you rather work? Where would you be most likely to get a job, in or out of the city?
4. Your uncle Charlie is thinking about opening a small restaurant in Denver or the surrounding suburbs. Where would you advise him to open his restaurant, in Denver or in one of the suburbs? Why?

Or

D. Many local governments around the nation are concerned with the problem of teenage smoking. A wide variety of legislation has been passed with the intent of reducing sales of cigarettes to minors among the methods currently in use are:

- requiring a picture ID before purchase;
- banning cigarette machines in public access areas; -moving
- cigarette machines behind the counter in bars and restaurants;
- fining underage purchasers of cigarettes; and
- fining those who sell cigarettes to minors.

1. Analyze the above options in terms of their cost. (What is the cost and who bears it?)

2. Predict the impact of each option on the demand, supply, and price in the market for cigarettes.

3. Can you separate these impacts for teenagers and adults? Which impacts would be the same, which impacts would be different?

4. What is the difference in market impacts of fining the buyer vs. fining the seller of cigarettes?

Set Three

E. The Dutch city of Amsterdam has had effective rent control since the Second World War. Despite its considerable charm, Amsterdam has many decaying and burned-out buildings. This is surprising, since everyone agrees that there is a severe housing shortage in Amsterdam. Connie is a women who lives in a rent-controlled apartment building facing a canal. A few years ago Connie paid a plumber to install a shower in her apartment after years of futile requests to her landlord for a shower. If she leaves the apartment (which she is unlikely to do), she expects to charge the incoming tenant for the shower.

1. What is meant by a "shortage" of housing? Can you illustrate a shortage situation on a supply and demand graph?

2. Using supply-demand analysis, can you give a plausible reason why Connie's landlord would be so unresponsive to her requests for a shower?

3. Why didn't Connie just get mad and move rather than paying for the shower herself?
4. Can supply, demand, and price analysis help to explain why there are a number of decaying and burned-out buildings in Amsterdam?

Or

(to focus specifically on marginal analysis).

F. Suppose you run a lawn mowing business: you charge $15 per lawn and you can mow five lawns in an eight hour day. You currently have more people asking you to mow their lawns than you can satisfy so you are considering hiring someone to help. Your other option is to buy or rent a riding lawn mower that will enable you to mow seven lawns each day. You find that your friend Jim, a good worker, will work for $8 per hour or you can rent a riding mower for $100 per week plus $25 for gas and oil. You estimate that you can sign up an additional 25 customers.

1. Should you hire Jim or rent the mower and do the work yourself? Which would be more profitable?

2. What if the mower enabled you to mow eight lawns per day, would your decision be the same?

Definitions

Demand - The relationship between prices and the corresponding quantities of a good or service buyers are willing to purchase at any given point in time.

Exchange - Trade or voluntary agreements between buyers and sellers.

Marginal analysis - A comparison of the costs and benefits of consuming or producing an additional unit.

Market clearing price - The price at which all that suppliers are willing to sell equals all that buyers are willing to purchase; the price at which quantity demanded equals quantity supplied; the price that "Clears" the market.

Supply - The relationship of prices to the quantities of a good or service sellers are willing to offer for sale, at any given point in time.

Transaction costs - The resources (like time and energy) that are used in making an exchange. An example of a transaction cost is time spent shopping or the time and energy necessary to negotiate a contract.

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EFL Lesson Five

INCENTIVES, PROFIT AND THE ENTREPRENEUR

Key Terms:

Profit
Property Rights
Entrepreneur
Resource Allocation
Competition
Incentives
Residual Claimant

National Content Standards Addressed:

Standard 4 - People respond predictably to positive and negative incentives.

Standard 8 - Prices send signals and provide incentives to buyers and sellers. When supply or demand changes, market prices adjust, affecting incentives.

Standard 9 - Competition among sellers lowers costs and prices and encourages producers to produce more of what consumers are willing and able to buy. Competition among buyers increases prices and allocates goods and services to those people who are willing and able to pay the most for them.

Standard 14 - Entrepreneurs are people who take the risks of organizing productive resources to make goods and services. Profit is an important incentive that leads entrepreneurs to accept the risks of business failure.

Standard 15 - Investment in factories, machinery, new technology, and in the health, education, and training of people can raise future standards of living.

Lesson Objectives (8)

1. All people respond to incentives.
   - Review the definition of incentives from lecture #2.
   - Elicit examples of both positive and negative incentives; elicit examples of both positive and negative incentives in a market.

2. Profit is an incentive; it motivates entrepreneurs to accept the risk of acquiring and organizing resources to seek market opportunities.
   - Discuss profit as total revenue - total cost (including opportunity cost).
   - Differentiate between accounting profit and economic profit;

emphasize that the difference lies in consideration of all opportunity costs.

3. An entrepreneur is a "residual claimant."
   - The entrepreneur takes whatever profit or loss results from an enterprise.
   - The entrepreneur acquires the cooperation of others (by meeting their terms - that is, their opportunity costs) in a productive endeavor and accepts responsibility for the outcome.

4. The expectation of profit encourages increases in production and attracts new suppliers; lack of profit signals businesses to reduce production or exit the market.

5. Competition, including entry of new businesses, reduces margins of profit and encourages an on-going search for improved products and lower-cost methods of production.

6. Governments encourage entrepreneurial activity when they secure clear property rights and protect freedom of exchange.

7. When there is no residual claimant, there is less incentive to reduce the costs of providing goods and services or to improve product quality and service.

8. Examples of collective ownership or government providers of services, like the Department of Motor Vehicles, illustrate the problems associated with the absence of these incentives.

Teaching and Discussion Ideas:

Introduce the lesson with the three minute EFL video of 4 - 5 entrepreneurs explaining why they went into business. Point out in discussion that while the incentives varied, each entrepreneur organized resources and production because of the incentive that was important to him.

Sample Interactive Discussion Problems:

Pose an example of something with an "outrageous" price and ask for explanations of why this price persists in a competitive market.

1. Suppose that, since so many Americans are angry about the profiteering of drug companies, a bill has been introduced in Congress to have the FDA take over the production of all drugs.
   - Predict the result of such legislation:
     - What will happen to the price of drugs?

- Who will pay?
- How will we decide which drugs will be produced?
- What will happen to the discovery of new, safe, and effective drugs?
- How will decisions be made about which diseases drug research should target?
- In what ways do the incentives facing government producers differ from those facing private entrepreneurs?
- How does the existence of private drug companies, run by entrepreneurs, change your answers to the above questions?

2. You may want to let students discuss the question of what is the right or acceptable level of profit.
   - Ask them to determine how profit should be measured: For example, if it is measured as a percentage, then of what should it be a percentage? (Both students and teachers tend to be under the misconception that there is some sort of correct answer to this question.)
   - Ask them to predict the consequences of setting acceptable levels of profit. Consider how this changes incentives for both buyers and sellers.

Definitions

Entrepreneur - One who is willing to risk loss in the attempt to make a profit from reorganizing market resources from low-valued to high valued uses. Entrepreneurs undertake the task of coordinating the employment of land, labor, and capital to produce goods and services.

Incentives - Rewards or punishments for behavior.

Profit - The difference between total revenue and total cost.

Property rights - The conditions of ownership, including the rights and restrictions regarding use, ownership, and sale.

Residual claimant - The owner of whatever is left (either profit or loss) when all the costs of production and sale have been accounted for. Entrepreneurs, by virtue of their willingness to risk failure, are the residual claimants to the profits of their enterprises.

Resource allocation - The method(s) used to determine ownership (property rights) to land, labor, and capital.

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EFL Lesson Six

Markets in Action

Key Terms:

Externalities	Property Rights
Transaction Costs	Cost/Benefit Analysis
Tragedy of the Commons	

National Content Standards Addressed:

Standard 1 - Productive resources are limited. Therefore, people cannot have all the goods and services they want; as a result, they must choose some things and give up others.

Standard 2 - Effective decision making requires comparing the additional costs of alternatives with the additional benefits. Most choices involve doing a little more or a little less of something: few choices are "all or nothing" decisions.

Standard 16 - There is an economic role for government in a market economy whenever the benefits of a government policy outweigh its costs. Governments often provide for national defense, address environmental concerns, define and protect property rights, and attempt to make markets more competitive. Most government policies also redistribute income.

Lesson Objectives (5)

1. Externalities, also know as spillovers or neighborhood effects, are any costs or benefits of production and exchange that are not taken into account by those who create the costs or benefits.
   - Examples of positive externalities include the benefits to passersby of a beautiful garden on a busy street, or the safer neighborhood for others that results from some residents hiringprivate security patrols.
   - Examples of negative externalities include an unmowed lawn ina suburban neighborhood, or automobile exhaust, or second-hand cigarette smoke.

2. Cooperation becomes more difficult and markets operate less efficiently when externalities exist, because individuals have no incentive to take into account the consequences of their actions for other people.

3. Externalities, both positive and negative, persist in situations where property rights are poorly defined or are unsecured.
   - Define property rights and give examples.
   - Sometimes, property rights remain undefined because the costs of defining them are prohibitive.
   - The existence of clearly defined and well-secured property rights creates incentives for owners to consider the value of conserving resources for future use.
   - The "Tragedy of the commons" refers to the lack of incentive to husband resources (like fish in a public lake) that are owned by everyone, and thus by no one (until they are caught).
   - Defining property rights more satisfactorily enables market processes to encourage productive cooperation instead of waste and conflict, as is demonstrated by the case of the African elephant or the use of pollution tax credits to reduce sulfur-dioxide emissions.

4. Government efforts to protect the environment or to eliminate pollution are most effective when they concentrate on establishing clear rights to property and freedom to exchange.

5. In considering nature, conservation, and the environment, marginal analysis is necessary to clearly evaluate alternative courses of action.
   - Define (or review) "marginal" and give examples.
   - Marginal analysis compares the anticipated additional benefit of a course of action to the anticipated additional cost (in terms of alternative benefits forgone).

Teaching and Discussion Ideas:

As a way of providing a concrete example, some professors like to create an externality during their lectures. Examples might include dropping trash or garbage as they talk, having someone make disruptive noise in the hall or the back of the room, or arranging to have a cellular telephone or beeper ring in the middle of the lecture.

Sample Interactive Discussion Problems:

Pose problems requiring students to compare situations where a tragedy of the commons exists to situations in which property rights are clearly defined and well-secured.

1. Consider the typical high school cafeteria. Why are most of the tables dirty and surrounded by trash, while the senior section is relatively clean?

2. Why is there graffiti on the walls of the school bathrooms, but not on the walls of your bathroom at home?

3. Why do you suppose that there are many people moving freely around the park, there is little visible trash, and the bathrooms are clean at Disney World, while at Yellowstone National Park, roads are congested and trash barrels often overflow?

Sample Small Group Discussion Problems:

Pose a problem requiring students to use the concept of property rights.

4. Cows and buffaloes provide similar benefits to humans. Why did the buffalo nearly become extinct while the cattle population was never endangered and continued to grow?
   - Why have buffalo populations recovered while other animal species remain endangered?

5. Present students with a brief description of the elephant situation in Africa, contrasting the growing population in some countries where elephant hunting licenses are sold, with the continued decline in countries where elephants are "protected" in large national parks and game preserves. Ask students to use property rights to analyze the mystery and to identify the operative incentives in each system.

6. Suppose that the Nature Conservancy, a nonprofit conservation organization, has just received a $100 million gift from the estate of a wealthy philanthropist. Recently, the Conservancy has been concerned about a piece of land near the Mississippi delta in Louisiana. Besides being beautiful, it is breeding habitat for endangered waterfowl. Unfortunately, the current owner has offered the land for sale and several oil companies are interested. The Conservancy and EPA are worried that drilling will destroy the fragile wetlands.
   - Formulate a plan:
     - What is the best course for the Nature Conservancy to take?
     - How can it best spend its money to advance its goal of conservation?
     - If the Conservancy decides to buy the land, are there any circumstances in which it should allow the extraction of oil and natural gas?

7. Suppose that the owner of a large parcel of land in California makes a deal to sell his land to a resort developer for several million dollars. The EPA blocks the deal by telling the developer that since an endangered species of kangaroo rat nests on the land, he may not build a resort hotel.
   - What has happened to the property rights of the people involved in this case?
   - Do you think this action by the EPA qualifies as a "takings?" (The Bill of Rights specifies that private property shall not be taken for

public use without just compensation.) Defend your answer.

Definitions

Cost/benefit analysis - A comparison of the costs and benefits of a choice in an effort to select alternatives that maximize the difference between benefits and costs.

Externalities - The cost and/or benefits that are not internalized by the processes of production and exchange, and which therefore spill over onto third parties. Externalities may be positive or negative. (Also known as spillovers or neighborhood effects.)

Property rights - The conditions of ownership, including the rights and restrictions regarding use, ownership, and sale.

Tragedy of the commons - Describes the phenomenon of overuse of resources held in common (i.e. by the "public" or by government) that occurs because the failure to adequately define property rights means that no one has an incentive to conserve or maintain the resource and all have an incentive to use the resource before others do.

Transaction costs - The resources (like time and energy) that are used in making an exchange. An example of a transaction cost is time spent shopping or the time and energy necessary to negotiate a contract.

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EFL Lesson Seven

Labor Markets

Key Terms:

Employment	Marginal Costs
Income	Unemployment
Marginal Benefits	Labor Supply

National Content Standards Addressed:

Standard 13 - Income for most people is determined by the market value of the productive resources they sell. What workers earn depends, primarily, on the market value of what they produce and how productive they are.

Standard 15 - Investment in factories, machinery, new technology, and in the health, education, and training of people can raise future standards of living.

Standard 19 - Unemployment imposes costs on individuals and nations. Unexpected inflation imposes costs on many people and benefits some others because it arbitrarily redistributes purchasing power. Inflation can reduce the rate of growth of national living standards because individuals and organizations use resources to protect themselves against the uncertainty of future prices.

Lesson Objectives (5)

1. In competitive labor markets, wages and benefits are determined by the supply and demand for labor.
   - Employers' decisions reflect the opportunity cost of hiring one worker over another or of using labor rather than other resources like capital.
   - Workers' decisions include consideration of wages, working conditions, welfare or unemployment compensation, and the costs and benefits of other opportunities.

2. The demand for any particular worker is determined by employers' estimates of his/her productivity.
   - The capital and technology available in the workplace directly-affect worker productivity.
   - Individuals' productivity reflects, in part, their investment in their human capital; that is, choices they have made about education,

training, skill development, and careers.
- Individuals without skills that others value are more likely to be poor.
- Examination of data on income by occupation supports the notion that the poor are by and large those with few valued skills.

3. Economic fluctuations may create conditions in which some workers are unable to secure employment.

4. The U.S. government defines the unemployment rate as the percent of the labor force not working.
   - By government definition, the "labor force" consists of those non-institutionalized individuals 16 years or older, who are working or actively seeking work.
   - The U.S. government defines the employment rate as the percent of the non-institutionalized population over the age of 16 that is currently employed.
   - The employment rate and the unemployment rate can be rising at the same time.

5. Government policies may impact the labor market by changing the incentives facing employers and/or workers.
   - Mandated benefits, legal constraints on personnel decisions, and threats of litigation increase the opportunity cost to employers of hiring additional workers.
   - Programs like welfare may create incentives for people not to work, as they decrease the opportunity cost of being unemployed.
   - Trade policies, minimum wage, and other legislation affect employment both in the U.S. and abroad.

Teaching and Discussion Ideas:

Use "Labor Market simulation" (by Professor Pat Fishe) during the lecture. Involve students as employers and workers interacting in a market. (corresponds to lesson objectives #1and #2)

Sample Interactive Discussion Problems:

Pose a problem in which students must analyze the differences in the labor markets for the same product sold in different locations.

1. The fast food restaurants in suburban Denver, Colorado, hire workers at a $6.50/hr. starting wage. One meal per shift is provided and most workers are held far enough below full time status that they receive no other benefits.

In Keystone, a mountain town serving the huge recreational ski industry of Summit County, less than an hour's drive from Denver, fast food restaurants pay a starting salary of $8.50/hr., and provide one meal per shift, daycare for employees' children, and health insurance for part time workers. Prices for fast food in Keystone are only marginally higher than in Denver restaurants.

What features of the labor markets help to explain the differences in workers' pay and benefits?

Sample Small Group Discussion Problems:

Pose a problem in which students face the decisions that today's employers confront.

2. Recent legislation and laws currently being discussed include mandated employee benefits - benefits that the law requires employers to provide for their employees, regardless of how much the benefits are valued by employees. Some examples of currently mandated federal or state benefits include:
    - up to 12 weeks a year of unpaid, job-protected leave, with medical benefits for childbirth, adoption, or illness of the employee or a family member;
    - protection against application of a mandatory retirement age; a minimum legal wage;
    - application to part-time employees of all benefits provided to full-time employees; and
    - "reasonable accommodations" to a job or workplace to enable a person with a disability to perform a job.

    Predict the effects of mandated employee benefits.
    - is this ever in the interests of employers to provide any benefits?
    - is it always in the interests of employees to have fringe benefits?
    - is there a difference between mandated benefits and those the employers provide voluntarily?
    - What groups would you expect to be better off as a result of mandated benefits?
    - What groups would you expect to be worse off?

Definitions

Income - Rent, salaries, wages, interest, and profit; payment received by the owners of resources when those resources are used to make goods and services.

Labor supply - The numbers of individuals willing to work for various wages at a given point in time.

Marginal benefit - The increase in total benefit that results from producing, purchasing, or consuming an additional unit.

Marginal cost - The increase in total cost that results from producing an additional unit.

Unemployment - Term describing the condition of those non-institutionalized individuals, over the age of 16, who are actively seeking jobs and unable to find them.

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EFL Lesson Eight

Inflation and Money

Key Terms:

Inflation	Money
Consumer Price Index	Money Supply
Interest Rate	Federal Reserve System
Discount Rate	Monetary Policy
Open market operations	Reserve Equipment

National Content Standards Addressed:

Standard 11 - Money makes it easier to trade, borrow, save, invest, and compare the value of goods and services.

Standard 12 - Interest rates, adjusted for inflation, rise and fall to balance the amount saved with the amount borrowed, which affects the allocation of scarce resources between present and future uses.

Standard 19 - Unemployment imposes costs on individuals and nations. Unexpected inflation imposes costs on many people and benefits some others because it arbitrarily redistributes purchasing power. Inflation can reduce the rate of growth of national living standards because individuals and organizations use resources to protect themselves against the uncertainty of future prices.

Standard 20 - Federal government budgetary policy and the Federal Reserve System's monetary policy influence the overall levels of employment, output, and prices.

Lesson Objectives (7)

1. Define money in terms of its functions.
   - Refer back to discussion of markets and the role of money in reducing transaction costs.
   - Give examples of types of money.

2. Inflation is a general increase in the level of prices throughout the

economy.

- The most widely recognized measure of inflation is the Consumer Price Index.
- The special Boskin Commission, after studying the measures of inflation, reported its conclusion that the CPI is overstated by about 1.1% and recommended revision of the method of measurement.

3. Unanticipated inflation alters the incentives normally created by price signals in the economy. (Refer to examples from the mentor teacher activity, "The Trial of Ms. Ann Flation," which immediately precedes the lecture.)
   - The incentive to save diminishes as inflation erodes the value of savings accounts and fixed incomes.
   - The incentive to spend and to accumulate debt increases as consumers act in anticipation of rising prices and wages.
   - Inflation creates additional uncertainty.
   - Predicting the future is more risky and mistakes are more costly.

4. Long-term and/or expected inflation may cause individuals and firms to alter their behaviors in response to anticipated changes.
   - Interest rates rise to cover the expected inflation rate.
   - Investors search for "inflation proof" investments.
   - Unions demand cost-of-living clauses in contracts.

5. Inflation rarely occurs except as a consequence of rapid increases in a society's stock of money.

6. The Federal Reserve System, an agency independent of but established by the federal government, controls the stock of money in the United States through monetary policy.
   - The Fed enacts monetary policy by changing the discount rate, by changing the reserve requirement, and/or through open market operations.
   - The Fed often faces political pressures from government, private interests, and the media to follow policies that cause the money stock to grow too rapidly for price stability.

7. The use of price controls in the aftermath of an increase in the money supply disguises inflation without eliminating it, and may lead to complete disruption of the system of resource allocation.

Teaching and Discussion Ideas:

1. Refer to the "Trial of Ms. Ann Flation," mentor teacher activity conducted in the session immediately preceding this lecture. Ask students to identify ways in which the witness/victims might have altered their behavior in the

face of continuing inflation.

2. Note: On Friday, some of the mentor teachers use an activity called "Foreign Currency and Foreign Exchange," which relates to the problem of the purchasing power of inflated currency. If the mentor teacher does not intend to use the activity, the following can be incorporated into the lecture:
    - Sell 3 candy bars or other small items during the lecture. Sell the first at auction (and do not let the students know that you have more, at this point), for U.S. coin or currency, and record the price.
    - Sell the second candy bar for U.S. coin or currency and/or a student's IOU, and record the price.
    - Sell the third candy bar for U.S. coin or currency, IOU, and/or play money which you've distributed liberally throughout the class, and record the price.
    - Lead a discussion about the resultant increase in price.
        - Was this inflation? (Technically, no, because it is a price rise of a single product, not a general price increase, but the rise in price can be used for illustrative purposes.)
    - Why did the price rise? (Credit and play money)
    - How could the price be kept stable? (increase production, limit credit, and don't pass out play money)
    - If play money is acceptable in exchange for the candy bar, is it money?

This discussion leads in nicely to the role of the Fed and the components of monetary policy.

Sample Small Group Discussion Problems:

Pose a problem in which students must calculate the potential impact of inflation on their own lives.

1. Suppose that your parents saved $50/month for your college education, beginning in the month you were born. A wise investment counselor has managed to earn about $5,000 with that money over the last 16 years. It currently costs about $5,000/year to attend your local state university. Inflation is heating up and is expected to run 5%/year. Will you have enough money to go to college?

Definitions

Consumer Price Index (CPI) - The most commonly used measure of inflation, calculated by comparing the price of a designated "market basket" of goods and services in the current year to its price in a base year. The CPI is compiled by the U.S. Bureau of Labor Statistics.

Discount rate - the interest rate charged to member banks on funds borrowed from the Federal Reserve.

Federal Reserve System - The "Fed" was created by Congress as an independent agency in 1913. It serves as the nation's central banking organization; its functions include processing checks, serving as the government's banker, and controlling the rate of growth of the money supply.

Incentives - Rewards or punishments for behavior.

Inflation - An increase in the overall level of prices over an extended period of time.

Interest rate - The price paid for borrowing or saving money.

Money - The accepted common medium of exchange for goods and services in the marketplace that functions as the unit of account, a means of deferred payment, and a store of value.

Money supply - The narrowest definition of the money supply includes all paper bills and coins in circulation, currency, travelers checks, and checkable deposits (MI). A broader definition, M2, includes MI plus such near moneys as time and savings deposits, money market mutual fund balances and Eurodollars.

Open market operations - The buying and selling of government securities by the Federal Reserve System.

Reserve requirement-- The requirement by the Federal Reserve that banks hold a minimum percentage of deposits on reserve, unavailable for lending.

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EFL Lesson Nine

Actions of Government

Key Terms:

Incentives	Public Choice Theory
Rational Ignorance	National Debt
Taxes	Government Spending
Budget Deficit	Gross National Product (GNP)

National Content Standards Addressed:

Standard 16 - There is an economic role for government in a market economy whenever the benefits of a government policy outweigh its costs. Governments often provide for national defense, address environmental concerns, define and protect property rights, and attempt to make markets more competitive. Most government policies also redistribute income.

Standard 17 - Costs of government policies sometimes exceed benefits. This may occur because of incentives facing voters, government officials, and government employees, because of actions by special interest groups that can impose costs on the general public, or because social goals other than economic efficiency are being pursued.

Standard 18 - A nation's overall levels of income, employment, and prices are determined by the interaction of spending and production decisions made by all households, firms, government agencies, and others in the economy.

Standard 20 - Federal government budgetary policy and the Federal Reserve System's monetary policy influence the overall levels of employment, output, and prices.

Lesson Objectives (6)

1. Economic reasoning helps us to answer the question of what things we should want and expect government to do: Government should do those things which it can do better than people can do without government.

2. One criterion for determining what government should do is to consider

whether the situation involves the free rider temptation. -The free-rider problem refers to situations in which non-payers cannot be excluded from benefits. Examples include national defense, street paving, fire protection, etc. - Coercion (by government) can overcome the problem by ensuring that all beneficiaries bear part of the cost.

3. Like decision-makers in the market, public servants respond to incentives.
   - Incentives in the political process may be different than those of the market.
   - Elected public officials face different incentives than career government employees.

4. The distribution of costs and benefits within our system of government helps to explain both the phenomenon of "rational ignorance" among citizens and the disproportionate influence of special interest groups in the political process.
   - For special interest groups, the benefits of political action are concentrated and the costs are diffuse.
   - For citizens/consumers/voters, the costs of political action are concentrated and the benefits are diffuse.

5. The history of the federal budget deficit is a striking example of the disproportionate influence of special interest groups, who typically want increases in spending and/or reductions in taxes.
   - Historically, balanced budgets were characteristic of American government until the Great Depression. In the years following the Depression, deficit spending has been the more common practice.
   - Until the 1970s, debt grew less rapidly than nominal GDP; during the 1970s, they grew at the same rate. During the 1980s, debt began to rise more rapidly than the nominal GDP. Currently the debt is over 70% of GDP.
   - The cost of deficits includes the opportunity cost of using government revenues to pay interest, as well as the opportunity cost of government spending in general - the private spending that must be foregone.

6. The design of representative government is often flawed in that, even if most legislators wanted to balance the budget, individual legislators desiring re-election cannot risk voting for specific expenditure cuts and/or tax increases.
   - The key insight of 'public choice theory' is the recognition that elected officials define their best interests in terms of reelection, making them susceptible to pressure from groups most able to influence election outcomes.
   - Proposals to solve the "deficit problem" include term limitations and a balanced budget amendment.

Teaching and Discussion Ideas:

Sample Interactive Discussion Problems:

1. Farmers make up only 3% of the American population. Use public choice theory to explain why Congress consistently votes to continue farm price supports and subsidy programs that provide benefits to relatively few Americans and impose costs on many.
   - Are members of the House of Representatives or the Senate especially susceptible to pressure from agricultural lobby groups? Why?
   - Why might a legislator support aid to agriculture even if there are no farmers among his/her constituents?

Sample Small Group Discussion Problems:

2. Present students with the findings of the special Boskin commission charged with examining measures of inflation:
   - the CPI is overstated by about 1.1%; and
   - revision in the method of measuring the CPI could save the government billions of dollars in social security payments
   - Lead a discussion or debate on revising the CPI measuring process.
   - Ask students to role-play members of various interests groups that might be affected by a revision of the process.
   - Does public choice theory provide any insight into the debate or the positions of the various stakeholders?

Definitions

Budget deficit - The condition that exists when, in any given year, the federal government's expenditures exceed the total of taxes, fees, gifts and other payments. The deficit is bond-financed and adds to the national debt.

Gross Domestic Product (GDP) - The final value of all goods and services produced within the domestic boundaries of the United States in a year.

Incentives - Rewards or punishments for behavior.

National debt - The cumulative total of past deficits and surpluses, financed by the issuance of interest-bearing securities. the debt is owed to the holders of such government securities.

Public choice theory - The application of economic analysis to the political arena made possible by the realization that elected officials, like private citizens, are motivated by

self-interest. Officials whose self-interest lies in re-election are especially sensitive to the desire of special interest groups because of their ability to influence election outcomes through financial contributions and voter participation.

Taxes - Compulsory payments by individuals and businesses to government.

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EFL Lesson Ten

International Markets

Key Terms:

Imports	Exports
Specialization	Voluntary Trade
Exchange Rate	Comparative Advantage
Balance of Trade	Balance of Payments

National Content Standards Addressed:

Standard 5 - Voluntary exchange occurs only when all participating parties expect to gain. This is true for trade among individuals or organizations within a nation and usually among individuals or organizations in different nations.

Standard 6 - When individuals, regions, and actions specialize in what they can produce at lowest cost and then trade with others, both production and consumption increase.

Standard 7 - Markets exist when buyers and sellers interact. This interaction determines market prices and thereby allocates scarce goods and services.

Lesson Objectives (5)

1. Although the transactions are more complex, the essential characteristics of international trade are identical to those of domestic trade. Trade agreements, the rights and regulations that govern trade, are made by nations, but nations don't trade; individuals do. Voluntary trade will not occur unless both parties anticipate that they will benefit from the exchange.

2. As in domestic trade, voluntary international trade encourages specialization and interdependence. Increased international trade means greater production overall, greater specialization in production at lower cost, and higher average welfare for the citizens of both trading nations.

3. Trade protection policies have consequences (both costs and benefits) throughout the economy: for consumers, for workers in protected industries, and for workers in other industries.
   - The "trade costs jobs" argument is shortsighted, tending to focus on

how trade impacts import-competing industries and to ignore the impact on export-producing industries.
- NAFTA and GATT are examples of international agreements to reduce barriers to trade among nations.

4. Currency exchange rates result from supply-demand decisions.
   - Currency exchange rates reflect the expected relative purchasing power of national currencies; that is, they are determined by the supply of and demand for the currencies at home and by foreigners.
   - The subjective term "weak dollar" is sometimes used to indicate a perceived low demand for U.S. dollars relative to the demand for other currencies.
   - The subjective term "strong dollar" is sometimes used to indicate a perceived high demand for U.S. dollars relative to the demand for other currencies.

5. The "balance of trade" usually refers to the difference between a nation's merchandise exports and its merchandise imports; as such it is only one component of a nation's "balance of payments."
   - A trade deficit exists when the value of merchandise and services imported exceeds the value of merchandise and services exported.
   - A trade surplus exists when the value of merchandise and services exported exceeds the value of merchandise and services imported.
   - A deficit or surplus in merchandise and services will be exactly balanced by a surplus or deficit in financial assets.
   - When all exchanges (merchandise, services, and capital) are taken into account, financial flows always balance.

Teaching and Discussion Ideas:

Sample Interactive Discussion Problems:

1. Evaluate the following argument: "When the United States has international political disagreements with nations like South Africa,North Korea, or China, it is counterproductive to impose sanctions and cut off trading relations with the offending nation. Our interest, and indeed our long-term goals of fostering peace, democracy, and human rights, would be much better served if, instead, we did everything in our power to increase trade."

Sample Small Group Discussion Problems:

2. Suppose that, in exasperation over never-ending trade negotiations, the United States unilaterally removes ALL barriers to trade with Japan; (all tariffs, all duties, all quotas, all reciprocal agreements), and declares all

our markets open to Japanese products, regardless of whether or not the Japanese follow suit.

- Analyze the market for a specific product, predicting both short and long-term effects and the consequences for both an individual U.S. businessman and for the economy as a whole.
- Do the same for a Japanese businessman and the Japanese economy.
- Follow the chain of cause-and-effect as far as you can.

Definitions

Balance of payments - A record of all the financial transactions between a country and the rest of the world in a given year. It includes, in addition to the balance of trade, all other foreign exchange, such as the selling or purchase of bonds, stock, land, buildings, and businesses.

Balance of trade - A deficit or surplus in a country's merchandise trade with other nations; a comparison of the value of total exports to the value of imports.

Comparative advantage - The advantage in production of a good or service held by the producer whose relative opportunity cost of producing that good is lower than his trading partner's.

Exchange rate - The price of one country's currency in terms of another.

Exports - Goods, services, and resources produced in one country and sold to individuals and firms in another country.

Imports - Purchases by individuals and firms in one country of goods, services, and resources produced in another.

Voluntary trade - Exchange in which both parties choose to participate because they anticipate benefits.

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